

199924069

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Significant Index No.: 4941.04-00

Contact Person:

Telephone Number:

In Reference to:

OP:E:EO:T:3

Date: MAR 23 1999

Legend:

B =

C =

D =

X =

M =

N =

x =

y =

Dear Sir or Madam:

This is in reference to a letter dated November 12, 1998, from your legal representative, requesting rulings under section 4941 of the Internal Revenue Code (the "Code") with respect to the proposed transactions described below.

You (the "Taxpayer") are seeking a determination that your proposed partial funding of a bequest provided in the will of B (the "Will") to X (the "Foundation") by the transfer of a promissory note (the "Note") of an entity which is a disqualified person under section 4946(a) of the Code, and the holding of the Note by the Foundation will qualify for the exception to self-dealing provided in section 53.4941(d)-1(b)(3) of the Foundation and Similar Excise Taxes Regulations (the "Regulations") for property of an estate.

The information provided indicates that X has been recognized as exempt from federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3) and is a private foundation within the meaning of section 509(a). B died and left a Last Will and Testament (the "Will"), together with a First Codicil to the Will. The Will and Codicil were admitted to probate in the probate court having jurisdiction over the estate. C and D duly qualified as Independent Executrices (the Co-Executrices) of B's Estate. C and D, in their individual capacities, serve as members of the Board of Directors of the Foundation.

Under the terms of the Will, B left a bequest to X (the "Foundation") of \$x less the value of any gifts by B to the Foundation during her life. The estate of B (the "Estate") is the holder of a Promissory Note (the "Note") in the original principal amount of \$y from M, a general partnership in which C and D were the two general partners. C and D are jointly and severally liable under the Note. Pursuant to a business reorganization, the Note has been assumed by N, a limited liability company, and the Note has been personally guaranteed by C and D. C and D are the owners, managers, and officers of N.

Pursuant to their powers under the will, the Co-Executrices propose funding a portion of the bequest to the Foundation by the transfer of the Note to the Foundation. At the time of the proposed funding, a portion of the bequest will be deemed satisfied to the extent of the face amount of the Note, which is represented to be the fair market value of the Note.

Upon receipt of a favorable ruling on this request, the Estate will petition the probate court for approval of the proposed funding transaction. The Estate anticipates obtaining such approval before the termination of the Estate under section 1.641(b)-3(a) of the Income Tax Regulations (also, "Regulations").

B's will provides in Article I, Section F as follows:

"I give in fee simple to X (hereinafter may be referred to as the "Foundation") the pecuniary amount of X Dollars less the value of any gifts (valued at the time of gift) made by me to the Foundation during my life. This pecuniary gift may be satisfied in cash or in kind, at the sole discretion of my Executors, and any transfers to satisfy this gift shall be valued for the purposes of distribution at the value of the property on the date of distribution. If the Foundation is not then in existence, then this gift shall pass to the Foundation's successor organization or if there is no successor organization, then this gift shall lapse and pass with my residuary estate."

Article V, Section D of B's Will provides, in part, as follows:

"My Executors and Trustee shall have the power to sell, buy, lease, develop, partition, borrow, mortgage, encumber, or hypothecate whole or undivided interests in real or personal property on behalf of their

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respective estates both within and beyond the term of their respective estates."

Article V, Section C of B's Will provides that B's Executors shall have all administrative powers granted in under state law to a trustee. State law provides as follows:

"A trustee may contract to sell, sell and convey, or grant an option to sell real or personal property at public auction or private sale for cash or for credit, or for part cash and part credit, with or without security."

B's Will provides in Article V, Section E as follows:

"Unless specifically directed otherwise in my Will, my Executors may satisfy all gifts in cash or in property, or a combination of both, and similarly situated beneficiaries need not receive pro rata distributions of the same asset. Particularly in regard to the bequest to X, my Executors shall have the explicit power to choose which assets of my Estate will be used to fund such bequest."

Section 4941 of the Code imposes a tax on each act of self-dealing, directly or indirectly, between a disqualified person and a private foundation.

Section 4946(a)(1) of the Code provides, in part, that the term "disqualified person" means, with respect to a private foundation, a person who is —

(A) a substantial contributor to the foundation,

(B) a foundation manager,

(C) an owner of twenty percent (20%) of (i) the total combined voting power of a corporation, (ii) the profits interest of a partnership, or (iii) the beneficial interest of a trust or unincorporated enterprise, which is a substantial contributor to the foundation,

(D) a member of the family of any individual described in subparagraphs (A), (B), (C),

(E), (F), and (G) a corporation, a partnership, or a trust, or estate in which persons described in subparagraphs (A), (B), or (C) and (D) own more than

thirty-five percent (35%), respectively, of the total combined voting power, the profits interests, or the beneficial interests.

Section 4946(d) of the Code provides that for purposes of section 4946(a)(1), the family of any individual shall include only his spouse, ancestors, children, grandchildren, great grandchildren, and the spouses of children, grandchildren, and great grandchildren.

Section 4941(d)(1)(B) of the Code provides that the term "self dealing" includes any direct or indirect — "(B) lending of money or other extension of credit between a private foundation and a disqualified person."

Section 53.4941(d)-(2)(c)(1) of the Regulations provides that the lending of money between a private foundation and a disqualified person shall constitute an act of self-dealing. Except in the case of the receipt and holding of a note pursuant to a transaction described in section 53.4941(d)-1(b)(3), an act of self-dealing occurs where a note, the obligor of which is a disqualified person, is transferred by a third party to a private foundation which becomes the creditor under the note.

Section 53.4941(d)-(1)(b)(3) of the Regulations provides:

The term "indirect self-dealing" shall not include a transaction with respect to a private foundation's interest or expectancy in property (whether or not encumbered) held by an estate (or revocable trust, including a trust that has become irrevocable on a grantor's death), regardless of when title to the property vests under local law, if —

(i) The administrator or executor of an estate or trustee of a revocable trust either—

(a) Possesses a power of sale with respect to the property, [or]

(b) has the power to reallocate the property to another beneficiary. .

(ii) Such transaction is approved by the probate court having jurisdiction over the estate (or by another court having jurisdiction over the estate (or trust) or over the private foundation);

(iii) Such transaction occurs before the estate is considered terminated for Federal income tax purposes pursuant to paragraph (a) of Sec. 1.641(b)-3 of this chapter (or in the case of a revocable trust, before it is considered subject to sec. 4947);

(iv) The estate (or trust) receives an amount which equals or exceeds the fair market value of the foundation's interest or expectancy in such property at the time of the transaction, taking into account the terms of any option subject to which the property was acquired by the estate (or trust); and

(v) With respect to transactions occurring after April 16, 1973, the transaction either—

(a) Results in the foundation receiving an interest or expectancy at least as liquid as the one it gave up, [or]

(b) Results in the foundation receiving an asset related to the active carrying out of its exempt purposes.

The Co-Executrices propose funding a bequest to a private foundation with a pre-existing promissory note of a limited liability company that is a disqualified person as to the foundation. Under the general rule of section 4941(d)(1)(B) of the Code, the transaction would constitute self-dealing under section 4941 of the Code. However, section 53.4941(d)-1(b)(3) provides that a transaction involving property of an estate will not be self-dealing if it meets five (5) requirements. The proposed funding of B's bequest to the Foundation with the Note of N meets the five requirements as follows:

#### **1. Power of Sale or Power to Reallocate Property.**

The Co-Executrices possess the power under B's Will to allocate and, hence, "reallocate" Estate property among the beneficiaries to fund bequests. In regard to the bequest to X, Section E of Article V specifically provides that the Co-Executrices "shall have the explicit power to choose which assets in my Estate will be used to fund such bequest."

#### **2. Approval of the Probate Court.**

The proposed funding will be approved by the probate court having jurisdiction over the Estate.

**3. Transaction Occurs Before Termination of Estate**

The Estate has not been terminated for federal income tax purposes.

**4. Receipt by the Estate of Fair Market Value of the Foundation's Expectancy.**

At all times, the Estate will remain intact, and the fair market value of the Estate's assets remains the same. The partial funding of the bequest by transfer of the Note to the foundation will result in the Foundation receiving an amount which equals the fair market value of the Foundation's expectancy in the property at the time of transfer. The Estate will receive such benefit by virtue of fulfillment of its obligations under B's Will.

**5. Equal Liquidity.**

Under the language of B's Will, flexibility exists to fund the total bequest to the Foundation with any type of property, regardless of liquidity, so long as it is valued at the bequest requirement of a pecuniary amount of \$x, less any lifetime contributions. Thus, the funding of the bequest with the Note, does not result in the Foundation "giving up" any liquidity to which it was otherwise entitled.

Accordingly, we rule as follows:

1. The proposed partial funding of the pecuniary gift under the Will of B to the Foundation with the Note and the subsequent payment of the principal and interest due of such Note will not constitute acts of self-dealing under section 4941(b) of the Code provided that the face value of the note equals the fair market value of the Note.

2. The holding of the Note by the Foundation during the term of the Note, and the Foundation's exercise of any rights granted to it under the Note, will not constitute acts of self-dealing under section 4941(b) of the Code.

Because this letter could help resolve any questions about your exempt status and foundation status, you should keep it in your permanent records.

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If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

RS

Robert C. Harper, Jr.  
50-03055  
Chief, Exempt Organizations  
Technical Branch 3